

## The Bulgarian Economy, 2007, Late Q3

(Summary of the report by the Center for Economic Development)

### Macroeconomic Dynamics

Considering good Q1 results and the conjuncture indicators which register persisting record-high levels of the general business climate in the economy indicator, an upward trend of the business climate in services and high growth in industrial production, we expect total economic growth to continue at relatively high values in 2007.

↑  
Anticipated  
GDP growth

Till September 2007, **the general business climate in the economy indicator** continues at levels of 30 percentage points above its long-term value. However, from August on, the record-high business climate levels registered in NSI's business surveys since July of last year are going notably downwards. Despite that, in all four monitored industry sectors the business climate values remain steadily higher compared to a year back. The focus of Q3 is the dynamics of services where the business climate continues on an upward trend.

↑  
High values  
of the Business  
Climate  
Indicator

The intensive economic activity registered at the end of 2006 continues steadily at high levels in the first nine months of 2007, with indications of some delay in Q3. **We expect slight delay of total economic growth in Q3** to about 6.5 per cent and project growth of 6.4 per cent total for 2007 (against 6.7 per cent in Q3 of last year and 6.1 per cent total for 2006). The slowdown of business climate dynamics and deteriorated consumer confidence give us grounds to expect delayed total economic growth on a year-on-year basis in Q3 against Q2.

↓  
Delayed  
growth  
in industry

In a mid-term perspective we can **expect some delay of growth in industry**. The fact that growth in sales begins to slow down compared to growth in industrial production on a year-on-year basis (respectively 8.5 and 8.7 per cent for the first eight months of 2007) is in line with the emerging trend of lower industrial capacity load in the sector (down from the maximum of 75 per cent in October of last year, to 70 per cent in July 2007). This corresponds to a deteriorated business climate in the sector in August and lower supply of domestic and foreign orders in September. The business in the sector has rather unfavorable expectations for the condition of enterprises in the six months after the survey.

Our expectations for the dynamics of total economic growth till year end are based on currently available **first half of 2007** results for the GDP components on the production and the demand side. Real GDP growth continues at accelerated pace compared to growth registered a year back and stands at 6.4 per cent for the first six months against 6.0 per cent for the same period of last year and at 6.6 per cent in Q2 against 6.4 per cent for the same quarter of 2006. On the supply side, growth in 2007 Q1, compared to growth registered a year earlier, is formed by a slower decrease of value added in the agrarian sector and accelerated growth in industry and services. On the demand side, GDP dynamics is determined by continuing accelerated growth in internal demand. Investments register again record-high growth on a year-on-year

basis against the respective periods from 2001 on (29.6 per cent). Growth in the individual consumption of households also remains at high values (6.8 per cent). Considering the good economic growth data for the first six months of the year, it should be noted that in Q2 economic productivity restores its growth on a year-on-year basis in contrast to the earlier tendency of slower growth and even decrease in labor productivity observed in the previous two quarters.

↑  
Value added  
of the economy  
moves up

In the first half of 2007 **value added of the economy registers accelerated growth** (by 8.2 per cent against 6.1 per cent for the same period of last year). Growth in the value added generated by *industry* accelerates to 9.1 per cent. It is already higher than growth in services (8.8 per cent) and represents the highest growth in industry for the respective first six months of the years since 1999. In Q2 manufacturing is the fastest growing branch of industry with real growth of value added standing at 15 per cent (against 14.5 in Q1). Growth in construction slows down a little (to 11.6 per cent against 15.5 per cent in the previous quarter). Value added in mining and quarrying continues downwards. *Services* remain more contributive of GDP growth on the production side compared to industry. Growth in sector's value added accelerated to 8.8 in the first half of 2007 (against 6.2 per cent for the same period of last year). Financial mediation remains the most dynamic branch in the sector with growth in value added persisting at levels above 40 per cent. *The agrarian sector* registers a decrease of 2.3 per cent on a year-on-year basis (against growth of 2.5 per cent in Q1 and a slowdown of 5.3 per cent in Q2). There are no grounds to expect that the sector will restore to its last year levels.

↑  
Investments  
in equity  
grow

On the **demand side** of the economy, GDP growth of 6.4 per cent in the first half of 2007 is formed by higher contribution of internal demand at 14 percentage points and deteriorated negative contribution of trade in goods and services (7.5 percentage points). The higher contribution of internal demand in GDP growth is attributable to almost **double increase in the contribution of investments** in equity (up from 3.7 percentage points in the first half of last year to 7.3 percentage points now) and delayed contribution of individual consumption; dynamics of stocks is considerably less contributive, the contribution of final consumption remains negative, registering no change in volume. Deteriorated negative net contribution of trade in goods and services is accounted for by exports whose positive contribution decreases at a higher pace (down from 6.8 to only 2.7 percentage points) than the negative contribution of the imports of goods and services (down from 12.4 to 10.2 percentage points). In the first half of 2007 real **growth in investments in equity** reached 29.6 percent against 16.5 per cent for the same period of last year. In Q2, however, growth is already by some 10 percentage points lower against Q1 (respectively 35.9 and 24.7 per cent in Q1 and Q2). The highest amount of investments flows into manufacturing (20.6 per cent in Q2). **Growth in consumption slows down**, standing at 6 per cent in the first half of 2007 and practically equaling the value for the same period of last year (6.1 per cent). In Q2 growth stands at 5.2 per cent and is already slower than in Q1 (7 per cent) and lower than growth in the same period of last year (7.2 per cent). **The negative balance of trade in goods and services**, viewed as an element of national GDP, has deteriorated compared to the same period of last year (down from 20 to 24.2 per cent of GDP) because real growth in the

exports of goods and services has slowed down notably (to only 4.1 per cent against 11.2 per cent in the first half of last year) whereas growth in the imports of goods and services also slows down but at a lower pace (to 11.9 per cent against 16.1 per cent for the same period of 2006). It is interesting to note that on a quarterly basis exports increase at a higher pace in Q2 against Q1 while imports, on the contrary, slow down their growth in Q2.

Current  
account  
deficit  
increases



Latest available data about Bulgaria's balance of payments with the other world are for the eight months of 2007. **The current account deficit** increases on a year-on-year basis from 7.5 to 12 per cent of annual GDP. Over 96 per cent of current account deficit deterioration (by EUR 1312 m) is formed by growth in the balance of trade deficit and decreasing positive balances of current transfers and net incomes. Favorable is the contribution of the balance of services which is positive over the review period, increasing by EUR 277 m.

The growing **balance of trade deficit** (over EUR 5 b CIF/FOB in the period January – August 2007) is a major risk for the macroeconomic environment. The tendency of higher growth in imports than growth in exports persists. Some of this growth is attributable to higher internal consumer demand and facilitated lending, but most of it is accounted for by an expanding production base and the inflow of foreign direct investments. Changes in the commodity structure of exports are attributable to higher raw material prices on international markets as well as to a sustainable growth in the share of consumer and investment goods in total exports. The last two groups of goods also register the highest increase in imports. The dynamics of imports is attributable to high economic growth, increasing incomes, inflow of foreign capital and higher investment activity. Particularly active is trade with the European Union (62 per cent of exports and 58 per cent of imports), but natural as this increase in intra-Community trade may be for Bulgaria as an EU member, it poses certain risk for the national economy, should economic growth in the Community be delayed.

In the first eight months of 2007 direct **foreign investments** to Bulgaria (EUR 3.4 b) are 22 per cent up on the same period of 2006. This growth is expected to persist till year end and total annual foreign investments to exceed EUR 5 b. It is important to note that the share of FDI in real estate (35 per cent) is higher than the share of FDI in production (25 per cent) and financial mediation (20 per cent). This distribution has an indirect effect on the increasing current account deficit. Despite the concerns that the global lending crisis will affect exactly the real estate sector and the related construction, tourism and financial services, the interest to this sector persists as it is thought that its capacity for good return is not exhausted. The relatively good ratio of risk to return on investments in the country will still make Bulgaria attractive. An urgent public sector reform will be a condition for maintaining the level of foreign direct investments.



FDI  
move up

Inflation  
increases



In the first nine months of 2007 **inflation** in Bulgaria (i.e. the appreciation of consumer goods and services *measured by national CPI*) is 8.9 per cent on December of last year (against accumulated inflation of 2.5 for the same period of 2006 r.). As a result of a relatively rapid total increase of consumer prices registered in July, August and September inflation on an annual basis

doubled from 5.6 per cent in June on the same month of last year to 13.1 per cent in September on September of last year (against 5.6 per cent in September 2006 on September 2005). Higher total inflation in the summer months is attributable to unusual appreciation of foods (respectively by 4.8 per cent in July, 7.3 per cent in August and 2.1 per cent in September) conditioned by an unfavorable internal and external market environment. In the first nine months of 2007 foods are most contributive of the general dynamics of consumer prices and services. They appreciated by 14.9 per cent in September on December of last year and contributed 5.4 percentage points to total accumulated inflation of 8.9. We expect inflation total for 2007 (December on December 2006) to reach 12 per cent (against 6.5 per cent total for 2006).

The prices of the monitored *100 most socially sensitive goods and services* in the small consumer basket register more notable increase from the beginning of 2007 till September (14 per cent), which is formed predominantly by the increase in food prices, which is 19.6 per cent in the composition of this basket and generates a contribution of 11.3 percentage points.

Over a year (from August 2006 till August 2007) total *producer prices in industry* increased by 8.1 per cent, and domestic market prices – by 9 per cent. This indicates some speculative pressure on domestic market prices by producers and traders. Against a year back, most notable is the price increase in the food industry (respectively total increase of 19.2 per cent and 20.7 per cent on the domestic market), followed by the energy sector and metallurgy.

**The economically active population** in the country increases at almost the same pace as in the first six months a year back (by 2.9 per cent against 2.5 per cent in the first half of 2006) and is accounted for by growth in the number of employed persons in the first half of 2007 of 5.1 per cent (against 4.0 per cent in the same period of last year) and *accelerated decrease in the number of unemployed persons*, which stands at 18.1 per cent (against 10.5 per cent in the respective half of 2006). The lower number of persons outside the labor force (down by 118 thousand people to 3189 thousand in the first half of 2007) and the lower number of discouraged persons (down by 81 thousand people to 218 thousand) indicates that the economy generates jobs for people who have not participated in the labor market for some time.

Employment status dynamics remains contributive of *growth in the share of employed persons* (up from 86.7 per cent in Q2 of last year to 87.7 per cent in Q2 of 2007) at the expense of decreasing shares of employers, self-employed persons and unpaid workers.

In Q2 of 2007 we observe *favorable closing in of growth in employment and economic productivity*, which can be expected to break the downward trend in labor productivity persisting in the past few quarters. Accelerated total economic growth in Q2 against a year back (up from 6.4 to 6.6 per cent) and growth in value added (up from 5.8 to 8.7 per cent) is accounted for by accelerated growth in employment (up from 4 to 5.1 per cent) with parallel improvement of growth in productivity. Growth in value added per employed person improves from 1.4 to 4.9 per cent, whereas improvement of growth in GDP per employed person is more moderate – up from 2 to 2.9 per cent.

↑  
Unemployment  
decreases

*The unemployment coefficients (NSI methodology) continue on a downward trend. Total unemployment decreases to 6.8 per cent in Q2 against 9.0 a year back. However, the share of permanent unemployed persons (unemployed for over a year) in total unemployed persons has increased (from 54 to 57 per cent) while at the same time the permanent unemployment coefficient (the share of permanent unemployed persons in the economically active population) is improving from 4.8 to 3.9 per cent of the economically active people aged 15+. The unemployment coefficient improves most notably in the group of young people between 15 and 24 years – down from 20.5 to 12.6 per cent.*

## ESTAT Index of Business Climate



The business  
climate  
improves

Despite inflationary pressure, expensive fuels, approaching winter and the fact that data were collected when the teachers' strike was at full swing, and last but not least, contrary to team's expectations, in October the ESTAT index registered a new record-high value, up by almost one percentage point on the previous one. For a second time in the six-year history of the index we witness an annual peak in October. The precedent was in the autumn of 2005 when for the first time the indicator failed to "reckon" with the seasonal dependence of opinions.

On one hand, these facts speak of a stabilized condition of companies and an improved business environment. Of course, companies remain dependent on the processes and trends on macroeconomic level, but seem more emancipated from surface events.

On the other hand, they are indicative of a change in the mentality of entrepreneurs who analyze the conjuncture and do not respond to it in a rush as the population does. Only a year or two ago similarities in business and public opinion assessments prevailed over differences.

## Economic Policy

*Enterprise policy.* In the past period the international rating agency Fitch Rating affirmed its long-term foreign currency credit rating for Bulgaria at BBB and its long-term local currency credit rating for the country at BBB+. Affirmed were also country's ceiling at A- and the short-term credit rating at F3. The outlook remains stable. Strong growth underpinned by internal demand continues to support Bulgaria's rating. **Investments increase to 32 per cent of GDP, supported by the inflow of foreign capital.**

Promotion of investments in the country remains a priority. Amendments to the Investment Promotion Act took effect from September 1. In September the Government approved, although behind time, the new rules on the implementation of the Act. The Act preserves the minimum threshold for support at BGN 40 m of investment project value. Investors are divided into two classes – A and B, the first covering projects for over BGN 70 m and the second – for over BGN 40 m.

Commercial  
Register  
implementation  
delayed again



In the past period the business environment did not register any notable changes. **Commercial Register implementation was delayed again.** Lack of good communication between the Ministry of Justice and the Registry Agency which is to maintain the register is at the roots of this serious delay. There are also technical problems with register's development. The register is expected to be launched in early 2008. It was decided to set up an expert group in support of its implementation. The register will contribute to improved business environment and will enable the business to enter and obtain information in a reliable and expedient manner.

Corruption has a negative effect on the conditions for doing business. In late September, Transparency International – Bulgaria announced the Corruption Perceptions Index 2007 of the global civil society organization Transparency International. The index measures the level of corruption among public officials and politicians as perceived by business representatives, global analyzers, including experts in the respective country. Bulgaria ranks 64 (out of all 180 surveyed countries) with an index of 4.1. Romania is behind us with an index of 3.7, but our northern neighbor has improved its index by 6 percentage points against 2006. Moving up from 2.9 to 3.7 percentage points in the period 1998 – 2001, in the last five years (2002 – 2007) Bulgaria's corruption index stabilizes at levels around 4.0 percentage points which means that the country remains "sustainably corrupted".) This is indicative of low efficiency of the institutions engaged in counteracting corruption at all levels.

*Public finance.* Despite the contributions in the European budget, the consolidated budget of the country shows a considerable surplus again. The fiscal reserve is also moving up and stands at BGN 7.9 b at end of May.

At end of August, indirect taxes account for about 70 per cent of government tax revenues. Among direct taxes, corporate tax registers the highest collection rate – 100 per cent of the budgeted volume, accounted for by lower rates and economic growth.

Foreign government and government-guaranteed debt stands at EUR 4.2 b, down about EUR 470.6 m on December 2006. Growth in private foreign debt does not threaten financial stability in a short-term perspective.

Bulgaria's long-term financial stability is depended by accelerated structural reforms: business environment liberalization, privatization, curbing corruption, improving the efficiency of law-enforcement authorities and of the judicial system, etc.

Most significant changes are envisaged in the taxation of physical persons' incomes. In 2008, the progressive tax scale will be replaced by a flat tax with one of the lowest rates in the EU. The total effect for tax payers will be positive, differentiation of disposable net income will increase and the opportunities to provide incentives for the more qualified workers will improve. The reform will have a negative effect on the people in the lower income brackets. Syndicates insist on compensatory policies in favor of the affected groups.

Excise on cigarettes, unleaded oil, gas oil, kerosene, coke, coal, electricity for business purposes is increased. Excise on bio-fuel – liquid fuel mixes is decreased. Excise on coffee is abolished. The patent tax becomes a local tax. Municipal councils are delegated the authority to determine the amount of local taxes within the limits prescribed by law. Technical changes are made in

Flat tax  
introduced



the field of corporate taxation and value added tax, but they will not change these taxes significantly in 2008.

*Social and health policy.* The Government has set the fiscal framework for the income policy in 2008. With projected annual inflation of 3.7 per cent, budget salaries and pensions will be indexed by 6.9 per cent at half-year end. Indexation does not take full account of 2007 inflation and 2008 projections are highly optimistic. The minimum salary is increased from BGN 180 to BGN 200 and the minimum monthly income for social security purposes is set at BGN 240. These parameters are aimed at increasing real incomes, but that will depend on whether high growth in consumer prices registered in 2007 will be leashed.

Since 1 October 2007 the social insurance contribution is decreased by 3 percentage points – one point for the Pensions Fund and two for the Unemployment Fund. Expectations for higher collection rate in the next year are based mainly on higher salaries. The new social security thresholds for 2008 were announced in September. They are increased by 26.8 per cent on average. In some branches like construction, food industry, etc. the increase reaches 35-35 per cent. The jump in minimum thresholds poses some risks to labor contracts flexibility. Agreed levels are based on the general expectations that unregulated incomes will decrease after a flat tax is introduced and the social security burden is lowered. These expectations are not based on accurate forecasts of labor force demand. Thus the high minimum salaries and wages in some sectors might ruin the whole positive effect of the fiscal relief. After repeated delays, the Ministry of Health published the draft National Health Strategy, 2007-2013. Restructuring and efficient management of hospital care is laid down as a major strategic goal. The ban on the privatization of hospitals will be lifted, but the draft does not provide specific deadlines and an action plan in this area.

*Environmental policy.* At the end of Q3, the public debate on environmental policy focused on the fulfillment of Bulgaria's commitments under the European bird and habitat directives (known as environmental network NATURA 2000) and on government and business preparedness to absorb the allocations from the European structural funds for improvement of the environmental infrastructure and the general condition of the environment.

Some progress has been made in the area of biodiversity with the approval of an almost finalized variant of the areas to be included in the European environmental network, but the question of the future development of the Black Sea coastal areas remains open.

Development of water and waste management infrastructural projects is going on in line with the priorities of Operational Program "Environment".

Along with waste management, the climate change policy is the second area which EC highlights as unsatisfactory in its official assessment. If some progress is not achieved on the waste management in Sofia Municipality and on the improvement of green gas monitoring, EC may launch a punitive procedure against Bulgaria.

The climate change policy depends on the EU approval of the National Allocation Plans for greenhouse gas emission allowances trading for 2007 and 2008-2009. The Commission did not recognize the emission quotas distribution mechanism described in Government's calculations as adequately reflecting the economic condition of Bulgarian companies and their capacity to join the European pollutant emissions reduction scheme. The Commission decided to reduce total emissions allowance granted to Bulgaria by 37.4 per cent. Accordingly, the maximum amount of allowances for Bulgarian installations is to be reduced by not more than 12.55 per cent of the previously set quota for every installation. Bulgaria, through MEW, intends to appeal Commission's decision. As far as the question is about differences in principle in the development of a document, significantly important for the formulation of future strategic goals for the Bulgarian industry, there is still room to arrive at a reasonable compromise on national interests and Community goals in this area. The result will be depended by Bulgarian administration's competence and the reasonable and principled approach in identifying sector policy priorities on national level.

## Financial Sector

*Banking system.* A clear upward trend in money supply is registered at the end of Q3, conditioned mainly by high economic growth, increased incomes of households and the inflow of foreign capital. Accelerated growth in deposits with relatively stable growth in broad money is a positive indicator of confidence in the banking system.

All interest rates are moving upwards, triggered mainly by higher interest rates on international markets and in particular in the Euro Zone. One could say, however, that loans denominated in foreign currency, in particular in euro, are more sensitive to international market developments. In the past year short-term deposits register higher growth regardless of the currency of denomination, whereas long-term interest rates remain relatively stable. In the past months growth in fixed-term deposits is more pronounced in those denominated in BGN, whereas the ones denominated in foreign currency register smoother increase. This may be attributable partly to a slower growth of deposits in BGN and to banks' efforts to compensate for it with higher interest rates.

Growth in the banking system continues upwards, triggered by growth in attracted funds and in banks' capital. Bank loans to the private sector register increase as well. In August, loans to corporate clients account for the highest share in banks' portfolio and stand at 50 per cent. The share of loans to households is 28 per cent. On the whole, the share of bad debts of enterprises and households registers a downward trend over the year.

BNB approved Ordinance No. 21 on the minimum required reserves maintained with BNB by banks and since 1 September 2007 the amount of these reserves is increased from 8 per cent to 12 per cent of banks' deposit base. The increase of the minimum required reserves aims at setting the bank credit growth rates at moderate and sustainable levels which will not



The banking  
system  
remains  
stable



jeopardise the stability of the banking system. BNB expects the impact of that measure to materialize in two ways: by means of withdrawing of liquidity from the banking system and by means of increasing the cost of attracted resources of commercial banks, which will be transferred over entirely or partially into the cost of credit, and hence will impact the credit demand. Another expected impact of higher minimum reserve requirements is that reduction of bank credit growth rates down to more moderate levels will also relieve the country's balance of payments of the pressure from the strong domestic demand.

Leasing market expansion continues. Financial leasing receivables account for a major market share, reaching 97.5 per cent. Total financial and operational leasing receivables increase by 75.4 per cent on a year-on-year basis. In July 2007 BNB approved Main Principles of the BNB Licensing Policy. The basic objective of these principles is to set up clear criteria for the assessment of banking license applicants.

*Insurance sector.* The Green Card Agreement took effect since 1 August 2007. Thus Bulgarian drivers are no longer required to present a Green Card at border control when traveling in the countries of the European Economic Area and in Andorra, Switzerland and Croatia.

Important new amendments to the Insurance Code were made in mid-2007, which are expected to be adopted by the end of 2007. Some of these amendments aim at further aligning Bulgarian with European insurance legislation. However, the better part of the supplements concerns the regulations on the protection of insurance service consumers.

In the first half of 2007 the income generated by insurance companies on the Bulgarian market is BGN 700.6 m, accounting for growth of 19.3 per cent on a year-on-year basis. 15.4 per cent of this income is generated by life insurance and 85 per cent – by general insurance.

Growth in the income generated by general insurance is attributable mainly to a high growth in motor vehicle insurance, whereas growth in property insurance has slowed down notably. While insurance market development is still modest, there is a clear trend of accelerated growth in this market observed both in life and general insurance.

*Capital market.* At the end of the first nine months of 2007 trade on the local Exchange is very dynamic with notable growth in the prices of most registered companies, respectively in the market capitalization of the Exchange, as well as in the number of transactions and in registered turnovers. While 2007 Q2 gave grounds for optimism, growth in prices in Q3 raises concerns as to whether things have not gone beyond the point which makes any further purchase unreasonable. The upswing in Q3 has its explanations – mass entry of new investors in the market which moves up prices of financial instruments and the number of concluded transactions. For example, in Q3 this indicator is more than two times and a half up on the average value for last year and at the end of the period it registers growth of almost 4 times.

Turnover on the Exchange also registers strong growth, especially if we take into account the transaction on finalizing the transfer of 90 per cent of the capital of the biggest Bulgarian public company BTC AD, negotiated earlier.



Alignment with  
European  
insurance  
legislation  
continues



Mass entry  
of new investors  
on the capital  
market

Even if we take this transaction out of the statistics, growth in turnover would be twice that in 2007 Q2. Market capitalization also continued upwards to almost BGN 28 m or about 54 per cent of GDP at end September. This growth is attributable to the increased prices of most positions and not to a wider representation of the Exchange.

It should be noted that the efforts of the Exchange to engage attractive issuers in the stock exchange market certainly yields results, supported by the public offerings made so far and those expected by investors. This effect is enhanced further by the rapid upward move of the new companies. The entry of new issuers is a universal tool for solving possible overvaluation of Bulgarian public companies, as far as it would balance the demand and supply of financial instruments.

Choosing a new trading platform – *Xetra*, operated by the Frankfurt Exchange, the Bulgarian Exchange makes a big stride towards trade modernization and improved operating conditions on the Bulgarian capital market.

No substantiation  
for Belene NPP

## Main Economic Sectors



*Energy sector.* The new minister of economy and energy pronounced Belene NPP the most important investment project in Bulgaria but failed to present economic grounds for its efficiency and practicability. NEK is to select a strategic partner for Belene NPP by year end. The main criterion for the selection of companies will be their financial stability. If construction starts in early 2008, the first 1000 MW unit will be scheduled for commissioning in 2014.

No development  
registered  
on Nabuco



No developments are registered on Bulgaria's main alternative project for natural gas supply – the Nabuco Pipeline. Growing natural gas consumption in Europe and projected decrease of Gasprom reserves are good grounds to support the project, but for the time being it remains a risk one as far as its implementation deadlines are concerned. The implementation of the Burgas – Alexandroupolis Pipeline project is not certain either because of Russia's new requirements to the Bulgarian and the Greek side to secure oil for the pipeline in proportion to their share participation in the project.

Burgas-Alexandroupolis delayed



In late September the European Commission approved a third package of legislative proposals aimed at liberalizing further the electricity and natural gas market. The real opening of the national electricity market is still losing its grip. Legally, the market is liberalized since 1 July 2007 but NEK is still a monopolist and the only buyer of electricity from big national producers.

No improvement  
of road  
transport  
safety



*Transport.* The Ministry of Transport (MT) presented the report on its activity in the past two years. While progress is reported on some big infrastructure projects, MT is behind schedule in the implementation of its major priorities. Road transport safety and security is not improving, transport system modernization registers some progress but one can hardly say that in the past two years the quality of public transport services has improved notably. Building public-private partnerships for the construction of infrastructure also lags behind, although it was a priority in Government's program. The concession for Trakia Highway was delayed for over two years before its approval by Eurostat. With the annex to the contract signed in April the

concessionary assumes in full the construction and the financing risk, while the disputable insufficient traffic risk is shared equally by the state and the concessionary. The European commission launched a new investigation of the concession terms and conditions which means that the concession may well fail.

The BDZ crisis

persists



Among the big failures of MT in the past two years is the aggravating state railways crisis. The existing organizational structures of BDZ EAD and National Company “Railway Infrastructure” failed to optimize their activity, and their financial situation is deteriorating with every year. New organizational structures in line with future tasks were implemented in the two companies. The objective is to divide the financial flows of profitable and loss-generating activities.

The air transport sector registered stable growth over the past summer season. Data about the passengers attended at Burgas and Varna airports are not available yet, but growth is projected at about 10 per cent. If this projection comes true, by year end Varna airport will attend about 1.8 m passengers and Burgas airport could exceed 2 m passengers for 2007. Growth projections are supported by the expanding market shares of low-cost air carriers.



Growth in  
construction  
continues

*Construction and real estate.* In the first half of 2007 construction remained among top real growth sectors – in Q2 the value added generated in the sector is up 11.6 per cent. A driver of this growth is the high investment intensity – in 2007 Q2 construction attracted 14 per cent of total investments in the economy while generating only 6 per cent of the value added. The flow of foreign direct investments to the sector remains high as well.

In the period July – September 2007 entrepreneurs’ assessments of the business climate in construction are slightly more optimistic compared to the results of NSI’s surveys from previous months. There are a couple of problems that impede the activity of enterprises in the sector – shortage of labor, increasing prices of materials, financial problems.

In the first half of 2007 residential property prices moved up by 15.2 per cent to BGN 1 041.10/m<sup>2</sup> average for the country. In 2007 Q2 top increase of residential property prices registered the regions in North Bulgaria – Russe, Vidin, Plevna, Vratza, Silistra, and some regions in South Bulgaria like Haskovo and Smolyan. The period is characterized also by intensive development of industrial and logistics areas. Construction of shopping malls still enjoys high investor interest and many new projects have been started in this segment.

The Bill on the management of condominium ownership in residential buildings is to be introduced in parliament again. It will regulate the opportunity to associate for owners of property in residential buildings.

*High technologies.* In 2006 the volume of the Bulgarian telecommunications market amounts to BGN 3.028 b, says CRC’s report, whereby the tendency of sector growth at about 10 per cent continues for a second year in a row. In a logical follow up of global telecommunications market experience, Bulgaria also witnesses a fixed-to-mobile substitution, and Internet gradually widens its audience.

The business portal Econ.bg – the first Bulgarian site focused entirely on economics, was renovated and improved the quality of its services and user

options. The new focus in Econ.bg is its opening to users through a special forum where every user can give opinions or discuss interesting topics and issues.

*Tourism.* In the first seven months of 2007, foreign visitors to Bulgaria (excluding transit passengers) stand at 3.9 m people, up 6.88 per cent on the same period of last year. EU tourists account for the highest relative share – over 70 per cent of total arrivers to Bulgaria. This fact confirms the trend registered in previous years, i.e. that the EU is the biggest market of the Bulgarian tourist industry. In the first seven months of 2007 revenues from international tourism exceed EUR 1.34 b, up 16 per cent on the same period of last year.



Negligible growth  
in the number  
of tourists

Efforts to change Bulgaria's current tourist destination image of a place for cheap "all inclusive" holiday in big resort complexes continue. The number of tourists going inland and preferring alternative forms of tourism increases. Alternative tourism includes visits to historical and archaeological sites, attending folk customs and rituals, adventure tourism, extreme experience – rafting, horse-riding, paraplaning, etc. Settlements with preserved authentic architecture and environment are gaining popularity. Alternative tourism is more expensive and attracts guests of higher purchasing power. The number of Bulgarian tourists making use of these forms of tourism has been increasing lately.

A **Tourism Development Strategy**, 2013, drawn up by the Bulgarian Tourism Chamber and submitted to BSAT for approval, was presented in the review period. The strategy features proposals for discussion which will provide a basis for outlining future sector development.

The National Assembly passed on second reading the **Law on the Structure of the Black Sea Coast**. This is a long awaited event as the law is expected to bring some order in the construction activity along the Black Sea coast. The truth is that the passing of such a law comes terribly late and the ecological balance of many Bulgarian regions has been seriously damaged.

*Agriculture.* Two factors have been influencing the condition and development perspectives of agriculture in the past months. On one hand, bad weather damaged crops and yields were below projections (in particular in the grain sector), which brought about problems with securing the bread and fodder balance that quickly rippled down the chain to food producers and pushed prices up. The physical volume of agricultural production moved 2.3 per cent down on the first half of 2006 and its share in GDP dropped to 4.6 per cent. On the other hand, the European Commission gave positive assessment of the preparedness of the Bulgarian system to allocate European money and thus the threat of 25 per cent cut down of allocated annual direct farm payments was avoided. Completed structuring of the Paying Agency and building of the Integrated Administration and Control System give us grounds to presume that a substantial financial resource will flow to Bulgarian agriculture, which if properly allocated and used, could notably improve production efficiency. The Rural Development Program, which is to inherit SAPARD, was launched on 15 January 2008. It will make possible the absorption of over EUR 2.6 b in the period 2007-2013. And this is only the amount of European co-funding to

Weaker  
crop



Paying agency  
becomes  
operational

which national co-finance will be added. The problem is not insufficient finance any more, but the need to build the capacity for the absorption of these resources by both administrative authorities and direct beneficiaries – the farm producers.

### **EU Structural Funds and Regional Policy**

Preparation of major documents for absorption of allocations from the European funds has entered its final phase – official approval and signing of the operational programs by EC. In September and October EC approved three operational programs – Competitiveness, Regional Development and Administrative Capacity. Implementation of these programs was officially launched by giving start to the first project proposal submission procedures.

A Standing Subcommittee for the Absorption of European Funds was set up at the parliamentary European Affairs Committee. The Internet portal [www.evrofondove.eu](http://www.evrofondove.eu) was launched in the review period. It will provide free advice and information on how to finance business from the structural funds.

At EU level, towards enhancing control on the utilization of European funds, EC decided to set up a complete public register of all recipients of resources from the European Structural Funds and Cohesion Fund. EC launched the development of a project for the set up of a public register for all interest representatives working to influence decisions taken in the European Parliament, the Council of Ministers and the European Commission.